56646 B
(33)
77
23 pgs

No.06-937

In the Supreme Court of the United States

QUANTA COMPUTER, INC., ET AL.,

Petitioners,

v.

LG ELECTRONICS, INC.,

Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

BRIEF OF *AMICI CURIAE* AEROTEL, LTD., AEROTEL U.S.A., INC. AND AEROTEL U.S.A., LLC IN SUPPORT OF RESPONDENT

MICHAEL J. DOYLE
Counsel of Record
OSTRAGER CHONG FLAHERTY
& BROITMAN P.C.
570 LEXINGTON AVENUE
NEW YORK, NY 10022-6894
(212) 681-0600
Counsel for Amici Curiae

LEGAL PRINTERS, Washington DC • 202-747-2400 • legalprinters.com

QUESTION PRESENTED

Whether the Federal Circuit was correct in holding that respondent's patent rights were not exhausted by Intel Corporation's sale of a product to petitioners, where Intel was authorized under a license to manufacture and sell the product conditioned upon a restriction that Intel's customers could not use the product, without license, in systems covered by respondent's system and method claim patents.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

INTEREST OF THE *AMICI CURIAE* 1

STATEMENT 4

SUMMARY OF THE ARGUMENT 5

ARGUMENT 6

I. THE PATENT EXHAUSTION DOCTRINE DOES NOT APPLY TO AN EXPRESSLY CONDITIONAL SALE OR LICENSE 6

A. Only An Unconditional Sale Of A Patented Article Will Automatically Exhaust A Patent Holder's Rights In A Patented Method or System 6

B. There Can Be No Unconditional Sale Or Exhaustion Of Patent Rights If There Has Been No Consideration In The Bargain For Those Rights 8

Page

II. REASONABLE RESTRICTIONS, LIMITATIONS AND CONDITIONS MAY BE PROPERLY PLACED UPON DOWNSTREAM USERS OF PATENTED TECHNOLOGY 11

III. THE FEDERAL CIRCUIT'S RULE PROMOTES THE EFFECTIVENESS OF THE PATENT GRANT WHILE ENSURING A REASONABLE APPROACH TO THE EXHAUSTION DOCTRINE 12

IV. THE FEDERAL CIRCUIT'S RULE PROMOTES FAIRNESS AND APPORTIONS RISKS AND REWARDS FOR PARTICIPANTS INVOLVED IN DIVERSE TECHNOLOGY TRANSACTIONS 15

CONCLUSION 17

TABLE OF AUTHORITIES

Page(s)

Cases

Adams v. Burke,
84 U.S. (17 Wall.) 453 (1873) 6, 14

E. Bement & Sons v. Nat'l Harrow Co.,
186 U.S. 70 (1902) 12

General Talking Pictures Corp. v. Western Electric Co.,
305 U.S. 124 (1938) 11, 14

Keeler v. Standard Folding Bed Co.,
157 U.S. 659 (1895) 6, 9

Mallinckrodt, Inc. v. *Medipart, Inc.*,
976 F.2d 700 (Fed. Cir. 1992)..... 14

Mitchell v. Hawley,
83 U.S. (16 Wall) 544(1873) 6, 7, 8, 9, 11

United States v. General Electric,
272 U.S. 476 (1926) 12, 15

United States v. Univis Lens Co.,
316 U.S. 241 (1942) 7, 8

U.S. Constitution:

Art. 1, §8., Cl. 8 13

Page(s)

Statutes:

35 U.S.C. § 154(a)(1) 13, 16

35 U.S.C. § 271(d)(2) 9

Other Authorities:

U.S. Dep't. of Justice & FTC,
Antitrust Guidelines for the Licensing of Intellectual Property (1995)..... 9

BRIEF OF AEROTEL, LTD., AEROTEL U.S.A., INC. AND AEROTEL U.S.A., LLC AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

Aerotel, Ltd., Aerotel U.S.A., Inc. and Aerotel U.S.A., LLC (collectively, "Aerotel") respectfully submit this brief pursuant to Supreme Court Rule 37.3 in support of respondent.[1]

Aerotel urges the Court to affirm the judgment of the United States Court of Appeals for the Federal Circuit. In the alternative, Aerotel urges the Court to confirm that exhaustion does not apply where a patentee receives no monetary consideration from a manufacturing licensee, and expressly by contract reserves its patent rights against downstream users of its patented technology.

INTEREST OF THE *AMICI CURIAE*

Aerotel, Ltd. is a privately held Israeli technology company founded in 1985. The company concentrates its activities in the telecommunications

---

[1] Pursuant to Supreme Court Rule 37.6, Aerotel states that no counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution to fund the preparation or submission of this brief. No person other than the *amici curiae* or its counsel made a monetary contribution to its preparation or submission. The parties have consented to the filing of this brief, and their consent letters are on file with the Clerk's Office.

and medical technology fields, selling its products in over 30 countries.

Aerotel has a longstanding interest in the success of the United States patent system. Aerotel, Ltd. is the owner of, *inter alia*, U.S. Patent No. 4,706,275 (the "'275 Patent") entitled "telephone system," dated November 10, 1987.[2] The inventions of the '275 Patent are directed to systems and methods for providing telephone service to customers who have prepaid for that service.

Aerotel, Ltd. concluded its first license under the '275 Patent with Bell Atlantic Corporation in 1994. Thereafter, Aerotel, Ltd. organized Aerotel, U.S.A. Inc. and Aerotel U.S.A., LLC as its exclusive U.S. managing agents and U.S. licensing representatives for its '275 Patent.

Aerotel successfully obtained several licenses and litigation settlements in the ensuing years, including a litigation settlement in 1998 with NACT Telecommunications, Inc. ("NACT"), a manufacturer of systems for making prepaid telephone calls. In the settlement, Aerotel covenanted not to sue NACT for its future manufacture and sale of systems, on the condition that NACT notify each of its customers that they required a license from Aerotel to use the NACT system to practice Aerotel's technology under

---

[2] The '275 Patent expired in 2005.

the '275 Patent. Aerotel received no other consideration for its covenant not to sue NACT.[3]

In 2004, Aerotel commenced an action for infringement of the '275 Patent in the United States District Court for the Southern District of New York entitled *Aerotel, Ltd. v. Primus Telecommunications Group, Inc.*, Civil Action No. 04 CV 10292 (LMM), which is pending. One defendant in Aerotel's action asserts as a defense that it purchased its system for making prepaid telephone calls from NACT, and that Aerotel has exhausted its rights under the method claims in the '275 Patent vis-à-vis that defendant by authorizing NACT to sell a system covered by the '275 Patent system claims.

Aerotel has no direct stake in the particular dispute between petitioners and respondent. Aerotel does have a strong interest, however, in a fair and reasonable interpretation of the patent exhaustion doctrine, since it is both a patent holder and a manufacturer.

Patent exhaustion issues arise in an extraordinary variety of business and commercial contexts. In Aerotel's view, the issues are best evaluated, managed and avoided through the judicious use of reason, negotiation, risk assessment

---

[3] In the settlement, NACT expressly agreed that Aerotel had not exhausted its patent rights, and that it was not granting any license under its patent, either express or implied, to any NACT customer.

and compromise in private contracts between willing participants. Aerotel is most interested in a patent system with fair rules of exhaustion, which promote innovation in industry while balancing the interests of patent owners, licensees, accused infringers and the public.

STATEMENT

This case concerns the applicability of the patent exhaustion doctrine insofar as it relates to a technology transaction involving a patent licensor (respondent), a manufacturing licensee (Intel), and unlicensed downstream users (e.g. petitioners) of the patented technology.

In its agreement with Intel, respondent licensed Intel, for consideration, the right to manufacture and sell patented microprocessor and chipset components to downstream computer system manufacturers, such as petitioners, but received no payment for, and expressly reserved its rights as against downstream manufacturers to combine Intel's licensed components with other non-Intel components in separately patented computer systems.[4] Thus, Intel's downstream customers were expressly prohibited from infringing respondent's system

---

[4] Aerotel expressly preserved its downstream rights because it received no monetary consideration for its covenant not to sue NACT for the manufacture and sale of its patented systems, or, the use of the system by NACT customers in accordance with method claims of Aerotel's '275 Patent.

patents, and Intel's sales of licensed parts were conditional upon its downstream customers obtaining licenses from respondent.

Intel did not obtain a license for its customers under the system patents, thus, the applicability of the exhaustion doctrine is the issue before this Court.

SUMMARY OF THE ARGUMENT

The Federal Circuit ruled correctly that respondent had not exhausted its patent rights, because Intel's sale of licensed components was expressly conditioned on its customers obtaining a license to practice respondent's patented technology. Respondent bargained for a limited grant of its patent rights, expressly excluding from its license, the right for downstream practice of its system patents by Intel's customers. *See* Respondent's Brief at 2. Respondent received royalty payment from Intel solely for its manufacture and sale of components, expressly reserving its patent rights for use by Intel customers of these components in systems subject to separate and distinct patent rights.

The exhaustion doctrine does not apply insofar as respondent did not bargain for or receive "full value" for its technology. However, Aerotel submits that insofar as the Court determines exhaustion doctrine is implicated that it should not reach

transactions, as in Aerotel's NACT Agreement, where a patentee receives no monetary consideration for an authorized manufacture of a patented product or system, expressly reserving its rights as against downstream users of the technology. *See Keeler v. Standard Folding Bed Co.*, 157 U.S. 659 (1895) *quoting Mitchell v. Hawley*, 83 U.S. (16 Wall.) 544, 546-47 (1873)(requiring that "the consideration has been paid to [the patentee] for the thing patented").

ARGUMENT

I. THE PATENT EXHAUSTION DOCTRINE DOES NOT APPLY TO AN EXPRESSLY CONDITIONAL SALE OR LICENSE

A. Only An Unconditional Sale Of A Patented Article Will Automatically Exhaust A Patent Holder's Rights In A Patented Method or System

Analysis of the doctrine of patent exhaustion traditionally begins with *Adams v. Burke*, a nineteenth century case concerning coffin lids where this Court held "in the essential nature of things, when the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use." *Adams v. Burke*, 84 U.S. (17 Wall.) 453, 456 (1873).

The patent exhaustion doctrine is triggered only by an *unconditional* sale. *See Mitchell*, 83 U.S. at 547. Here, respondent's license to Intel was expressly limited to Intel's manufacture and sale of components, and by its express terms did not extend to Intel's customers the right to combine licensed components with other non-Intel components. Moreover, this conditional agreement required Intel to notify its customers of the limited scope of the license, which it did. Although, Intel was free to sell its components, those sales were conditional, and Intel's customers were expressly prohibited from infringing respondent's combination patents.[5]

Petitioners' proposal that patent exhaustion is triggered by *any* authorized sale of a patented article contravenes this Court's century old jurisprudence. Pet. Br. 1. Petitioners reliance on *United States v. Univis Lens Co.*, 316 U.S. 241, 250 (1942) for the proposition that after a sale, the patentee may only enforce breaches of contractual provisions but "may

---

[5] Aerotel similarly conditioned its covenant not to sue NACT. Aerotel's covenant not to sue expressly disclaims a grant of rights to NACT's downstream customers to use the patented system in a manner which infringed Aerotel's '275 Patent method claims without obtaining a license from Aerotel. Moreover, this conditional agreement required NACT to notify its customers of the limited scope of the license, which it did. Although NACT was free to sell its systems, those sales were conditional, and NACT's customers were expressly prohibited from using the systems in a manner which infringed Aerotel's '275 Patent.

not thereafter, by virtue of his patent, control the use or disposition of the article" by suing for patent infringement is misplaced. Respondent correctly asserts that "[t]he holding in *Univis* thus represents standard exhaustion doctrine: the *unconditional* sale of an article that embodies a patent exhausts certain rights arising from the patent that claims that article." Resp. Br. 29 (emphasis added). *Univis* does not support petitioners' rule that an authorized, but conditional sale of less than all of the patented technology, exhausts a patentee's rights. Petitioners' *per se* rule fails to recognize that a patentee may separately license different sticks in its bundle of patent rights to receive "full value" for its technology. *Mitchell*, 83 U.S. at 546-47. *See also* POINT II, *infra*.

B. There Can Be No Unconditional Sale Or Exhaustion Of Patent Rights If There Has Been No Consideration In The Bargain For Those Rights.

Should the Court reject the Federal Circuit's and respondent's rule, Aerotel urges the Court to hold that there can be no exhaustion of patent rights in situations where the patent holder receives no monetary consideration for a covenant not to sue a system manufacturer, and expressly reserves its rights against downstream users of the systems, where both the system and the method for using the system are patented.

The theory behind the patent exhaustion doctrine is that exhaustion occurs only when the patent holder has bargained for, and received, an amount equal to the full value of the goods that are subject to an unconditional sale. *See Keeler*, 157 U.S. 659 (1895) *quoting Mitchell*, 83 U.S. at 546-47 (requiring that "the consideration has been paid to [the patentee] for the thing patented").

The patent laws, however, impose no requirement on a patent holder to extract full value for a patented system at the outset of a technology transaction. Instead, consideration may be expressly reserved, by the parties to such transaction, for later licensing or enforcement with the ultimate users of the system. *See* U.S. Dep't of Justice & FTC, *Antitrust Guidelines for the Licensing of Intellectual Property* 5 (1995)("limitations on intellectual property licenses may serve procompetitive ends by *allowing the licensor to exploit its property as efficiently .... as possible.*")(emphasis added) This transactional approach is codified in the Patent Statute: "[n]o patent owner otherwise entitled to relief for infringement . . . shall be denied relief . . . by reason of his having . . . authorized another to perform acts which if performed without his consent would constitute contributory infringement of the patent." 35 U.S.C. § 271(d)(2).

Respondent correctly states that "[t]here is simply no way by which a patent holder, when licensing a manufacturer to produce and sell

patented components, could reasonably determine the value of a separate patented system to different downstream purchasers or rationally allocate the value of that system as part of the price of the component license." Resp. Br. 38, note 13. Application of petitioner's rule will require patent holders to inefficiently exploit their property rights by agreeing to value those rights before they have been exploited. Respondent did not receive "full value" for its patented systems because respondent and Intel intended to preserve respondent's ability to require separate licenses from Intel's customers under the system patents. There is thus no ground to deem the amount exchanged for the component license to represent the full value of the separate patented system, or to deem the amounts subsequently exchanged for licensing rights under the separate patents a "double" recovery that would require a conclusion of exhaustion as espoused by petitioner.

Aerotel's litigation settlement with NACT is a more extreme example of the injustice that would be served by petitioner's *per se* rule because Aerotel received no monetary consideration. Aerotel authorized a manufacturer to make and sell a patented system, but received no monetary consideration for that authorization, instead expressly reserving its rights to license or enforce its patent rights against downstream users of the systems. Aerotel's covenant not to sue NACT, and

reservation of its rights, precludes petitioner's concern of a "double recovery" or windfall.

II. REASONABLE RESTRICTIONS, LIMITATIONS AND CONDITIONS MAY BE PROPERLY PLACED UPON DOWNSTREAM USERS OF PATENTED TECHNOLOGY

This Court has repeatedly held that reasonable restrictions on a patented article may be enforced where the restriction passes with the article. The court held in both *Mitchell* and *General Talking Pictures Corp. v. Western Electric Co. Talking Pictures*, 305 U.S. 124 (1938) that the purchaser of an article from a manufacturing licensee takes the article subject to any restrictions that were imposed on the licensee by the patent holder, whether or not the purchaser has notice of those restrictions. *See Talking Pictures*, 305 U.S. at 127. Respondent's brief provides a useful survey of cases before this court where reasonable restrictions on a patent article were enforced where the restriction passes through a chain of ownership. *See* Resp. Br. 41-42

In contrast, Intel did not possess full patent rights in the patented systems. The licensing agreements with Intel expressly prohibited computer system manufacturers from practicing those patents with non-Intel parts. And, through their purchase from Intel, petitioners took the systems subject to that restriction. *Talking Pictures*, 305 U.S. at 127; *Mitchell*, 83 U.S. at 548. Petitioners are, for that

reason, prohibited from practicing those patents with non-Intel parts.

Second, notwithstanding this limitation on Intel's patent rights, the restrictions imposed on petitioners by respondent are independently valid under standard principles of patent law. Holders of a patent, like holders of any property, can sell distinct sticks from their bundle of property interests without losing the remainder. *E.g., United States v. Gen. Elec.*, 272 U.S. 476, 489-90 (1926). In other words, they may impose reasonable conditions on the sale of a patented article, so long as those conditions reasonably relate to the patent rights retained by the patent holder following the sale. *E. Bement & Sons v. Nat'l Harrow Co.,.* 186 U.S. 70, 91 (1902) ("[T]he rule is, with very few exceptions, that any conditions which are not in their very nature illegal with regard to this kind of property [the patent right], imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article, will be upheld by the courts.").

III. THE FEDERAL CIRCUIT'S RULE PROMOTES THE EFFECTIVENESS OF THE PATENT GRANT WHILE ENSURING A REASONABLE APPROACH TO THE EXHAUSTION DOCTRINE

Rigid application of petitioners' proposed rule of law would hinder commerce in general, and the ability of patent holder's to fairly value its

technology. The ultimate users of a product or system, not the manufacturer, often determine its true worth and benefit from its use.

The patent laws serve a valid and useful purpose and are valuable to the people and commerce of the nation. Further, patent owners and inventors have long benefited from a variety of rights granted them under the laws, regulations and constitution of the United States. These contributions and benefits spring from the constitutional underpinnings of the patent laws, ART. 1, SEC. 8., CL. 8, through the application of the statutory framework (e.g. the patent grant defined in 35 U.S.C. § 154(a)(1)), the regulatory mechanisms embodied in Title 37 of the Code of Federal Regulations, centuries of case law considered by this court, as well as the private law created by the parties to lawful contractual agreements.

Legally permissible patent transactions, implemented in commerce through arms length transactions instead of litigation, enhance innovation, foster certainty in commerce and finality in contracts among private participants. However, such permissible transactions do not exist in a vacuum and neither patent misuse nor antitrust violations are tolerated, these having separate appropriate remedies.

But the patent exhaustion doctrine under consideration here need not be so absolute that it

stifles what ought to be perfectly legal and reasonable activities. Disparate commercial transactions are replete with myriad facts and problems, which may be addressed efficiently by the direct parties to a transaction. Absolute, bright line rules cannot foresee all the permutations that a modern, vibrant economy will generate.

Business strategies and commercial contexts vary as widely as the parties involved. Activities reflected in countless transactions have been interpreted by numerous cases before this Court including, *inter alia, Adams v. Burke* and *General Talking Pictures*. Other courts, including the Federal Circuit, also give deference to the variety of transactional possibilities, including the validity of downstream uses of technology, express and implied licenses, and the many permutations and differing commercial terms required for these transactions. *See, generally, Mallinckrodt, Inc.* v. *Medipart, Inc.*, 976 F.2d 700, 704-708 (Fed. Cir. 1992).

When the principle value of technology or a license is downstream, an innovator cannot be expected to bargain away its rights for little or insufficient consideration. But the forms of consideration can often be found in the details of a bargain, such as a license agreement or a sale conditioned upon limitations or restrictions.

There is a place for the patent exhaustion doctrine, but it should not exist to cut off reasonable

downstream rights, which have not been bargained away. A patentee has always been permitted to unbundle the rights granted him. These rights may be bargained away and dealt independently. See *United States. v. Gen. Elec. Co.*, 272 U.S. at 490.

IV. THE FEDERAL CIRCUIT'S RULE PROMOTES FAIRNESS AND APPORTIONS RISKS AND REWARDS FOR PARTICIPANTS INVOLVED IN DIVERSE TECHNOLOGY TRANSACTIONS.

Reversal or limitation of the Federal Circuit's ruling would have enormous practical implications on the nation's commerce, creating unnecessary risk and litigation. Such risks and litigation can be readily minimized by preserving a reasonable rule regarding the exhaustion doctrine, rather than adoption of Petitioner's proposed absolute bright-line approach which will stifle legitimate transactions.

A patentee does not deserve duplicative royalties for that which has been previously sold, but the innovator should always be entitled to secure a fair value for each variety of its intellectual property, and at each stage of its use by a licensee or potential infringer. To force such a licensor to secure its full measure of fair compensation at the earliest stages of a complicated technology transaction will only serve to deprive the innovator of the true value of his contribution, because its ultimate value and variety can rarely be predicted with certainty. Persons

experienced in commercial transactions would be challenged to predict the myriad downstream uses of technology and it should not be an unusual or unreasonable situation for a licensor to fairly reserve some of its rights for future exploitation in both known and new developments.

For example, Aerotel's products and patents are among an untold number that could be adversely affected by a reversal of the Federal Circuit's rule. Such products and related methods and systems require complicated end-use arrangements for successful implementation and these often employ a wide variety of patent types, patent claims and the transferable rights associated with each patent grant. 35 U.S.C. § 154(a)(1).

The Federal Circuit's ruling in this case permits an owner of a patent to engage in appropriate and reasonable negotiations for a fair return on its innovation. A royalty strategy negotiated between willing parties will serve to address a wide variety of legitimate transactions that may not be anticipated today. A flexible, common sense approach to such transactions will not impose financial or practical burdens on manufacturers of technology products.

A manufacturer cannot be expected to contest every patent claim which may be presented, but such manufacturer is expected to exhibit due diligence in evaluating such claims. An evaluation of risks and rewards, and where necessary, negotiating

settlements, will foster commerce and innovation and avoid burdensome litigation.

CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals for the Federal Circuit should be affirmed. In the alternative, the Court should hold that exhaustion does not apply where a patentee receives no monetary consideration from a manufacturing licensee and reserves its rights against downstream users of its patented technology.

Respectfully submitted,

MICHAEL J. DOYLE
(*Counsel of Record*)
OSTRAGER CHONG
FLAHERTY & BROITMAN P.C.
570 Lexington Avenue
New York, NY 10022-6894
(212) 681-0600

Counsel for Amici Curiae

December 10, 2007